

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

-----X  
In Re: : 05-60006  
:   
REFCO, INC., : One Bowling Green  
: New York, New York  
Debtors. : September 11, 2007  
-----X  
TONE N. GRANT, et al, : 07-2005  
:   
Plaintiffs, :   
:   
v. :   
:   
AXIS REINSURANCE COMPANY, :   
:   
Defendant. :   
-----X

TRANSCRIPT OF HEARING  
BEFORE THE HONORABLE ROBERT D. DRAIN  
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

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(Appearances continued on next page)

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

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1 THE COURT: Grant v Axis Reinsurance in the Refco  
2 case.

3 MR. EISEN: Good morning, Your Honor.

4 Norman Eisen representing Mr. Grant and I will be  
5 arguing on the motion for advancement on behalf of Mr. Grant,  
6 Mr. Trosten and Mr. Bennett, although Mr. Trosten and Mr.  
7 Bennett's counsel are here as well and they may wish to join in  
8 at certain points.

9 THE COURT: Okay.

10 MR. EISEN: On behalf of everyone we want to thank  
11 the Court for taking the motion on an expedited basis. We  
12 believe that the fundamental issues that are raised by our  
13 advancement motion were raised and decided by the Court on the  
14 other insurance motion that we were before the Court on less  
15 than two weeks ago. As the Court knows, the criminal  
16 defendants -- we refer to them as the presumed innocent  
17 defendants in distinction to Axis designation -- joined in the  
18 motion for advancement we argued and the Court actually  
19 addressed in the course of its holdings -- actually addressed  
20 the prejudice to the criminal defendants with respect to the --  
21 on the balancing of harms.

22 I will just quickly go through the issues and I think  
23 reference to Axis' brief makes clear that fundamentally Axis is  
24 rearguing the issues that were before the Court the last time  
25 we were here on the question of what the standard is, whether

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1 this is a prohibitory or mandatory injunction. The Court has  
2 already invoked the reasoning of Worldcom and ruled. The Court  
3 has applied the test of a likelihood of success on the merits  
4 or a sufficiently serious question and balance of harms. There  
5 is no new issue in the brief about and we recognize the Court  
6 likely went to the sufficiently serious question and balancing  
7 the harms prong of that test. The Court noted as much when it  
8 was ruling previously. There is no new issue in the papers  
9 about the likelihood of success on the merits or the  
10 sufficiently serious question going to the merits. It is a  
11 reargument of the clause relating -- the disputed clause and  
12 the Court has already ruled on that.

13 On the balance of the harms, we would submit that,  
14 again, as noted by the Court the harms are even more severe  
15 because the criminal defendants are facing trial; it's not  
16 merely a question of a risk of financial loss, it is a liberty  
17 interest and the most serious liberty interest and any  
18 disruption in the preparation for trial as the Court noted is a  
19 very, very serious harm indeed.

20 One of the only -- I will not rehash absolutely every  
21 argument that the Court has head ad infinitum in the many, many  
22 papers that have been filed. I'll attempt to focus on what's  
23 new in Axis' submission and the response. They do rely on a  
24 new case in addressing the balancing of the harms, that is the  
25 Gaone v. Twin Cities case. We obtained from Axis --

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1 THE COURT: No one gave me a copy of that case.

2 MR. EISEN: Your Honor, we had the same problem --

3 THE COURT: And consequently I'm not going to  
4 consider it.

5 MR. EISEN: Okay. Then, Your Honor, really the only  
6 other significant --

7 THE COURT: Let me -- it's an unpublished decision.

8 MR. EISEN: Yes, it is, Your Honor.

9 THE COURT: You're all familiar with the Second  
10 Circuit rule on citing unpublished decisions. If I were to  
11 consider it as persuasive authority, simply like a Law Review  
12 article or the like, I would have expected the parties to have  
13 provided it to me since I prepare in advance for these things  
14 and this is a preliminary injunction hearing and that's not  
15 done and so I'm not going to consider it.

16 MR. EISEN: Understood, Your Honor, and we certainly  
17 are not relying on it and you won't hear anymore about it from  
18 us.

19 The only other issue of significance that is new in  
20 the papers is the priority of payments issue and that popped  
21 up, really, yesterday with the filing of Axis' opposition and  
22 then of the motion to intervene. With respect to proposed  
23 intervenors issues, we conferred with them before court this  
24 morning and we've also informed Axis of this, the movants today  
25 are satisfied to have the identical form of order that the

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1 Court entered last time with the addition of the proposed  
2 language that Mr. Klejna's counsel has requested which is to  
3 the effect that nothing in this order shall effect the priority  
4 of payments issue. We really do not view the priority of  
5 payments issue as procedurally appropriate for a decision  
6 before the Court. It has not been teed up. It is not ripe.  
7 We don't know if there is a disagreement yet. We haven't had a  
8 chance to evaluate it. Obviously, there's been no factual  
9 development, there's been no briefing. It really is a last  
10 ditch attempt to interpose an obstacle to the payment of the  
11 fees that the movants today so desperately need in order to  
12 avoid disruption of the criminal case.

13 So the issues really being the same we would submit  
14 to the Court that it is a straightforward application of the  
15 decision that the Court has already rendered and, indeed, was  
16 prepared to render but for the Court's request that we file an  
17 adversary proceeding of our own and a motion for preliminary  
18 injunction which we've done.

19 THE COURT: What is the -- and there was some  
20 confusion about this last time -- billed amount of the defense  
21 costs for the three defendants?

22 MR. EISEN: Your Honor, Axis has provided that  
23 information on Page 30 of their opposition and I'll go over  
24 that and then I will relate an issue -- conversation that we  
25 all had amongst ourselves in the hallway just updating that and

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1 I know Axis' counsel will correct me if I err.

2           When we were before the Court the last time the total  
3 amount was in the neighborhood of \$2 million for Axis. As of  
4 Friday, the total amount at issue was in excess of \$2.9  
5 million. We certainly do not -- I think it's our position and  
6 the other insured's position that none of us begrudge the  
7 payment of those sums to the other. Indeed, for the criminal  
8 defendants it is crucial because the pipeline is building up  
9 and we have so much work to do and the consequences are so  
10 great. We would ask the Court to order payment of that amount.  
11 Approximately \$300,000.00 of that \$2.9 million has already been  
12 paid down or is in the process of being paid down.

13           THE COURT: Well, let me make sure of that. The  
14 aggregate number you gave me, the \$2 million as of last Friday  
15 --

16           MR. EISEN: It's \$2.9 million, Your Honor, as of  
17 Friday.

18           THE COURT: I'm sorry. Then there was \$2 million as  
19 of the hearing that we had.

20           MR. EISEN: Yes, Your Honor.

21           THE COURT: That includes the defense costs of which  
22 defendants?

23           MR. EISEN: I believe that includes the defense costs  
24 of all of the parties who were before the Court on the previous  
25 motions and --

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1 THE COURT: Well, let me make sure. It does not  
2 include Mr. Lee; right?

3 MR. EISEN: I do not know if it includes or not. I  
4 can speak for the five insured individuals represented by  
5 Baker, Hostetler and the other firms and I can speak for the  
6 three criminal defendants. I cannot at all speak for Weil,  
7 Gotshal's clients, for Mr. Lee. I'm sure Ms. Gilbride knows  
8 the answer to that question. I do not.

9 THE COURT: All right.

10 MR. EISEN: And just to update the Court there have  
11 been approximately \$1 million in additional invoices that have  
12 come in over the weekend and yesterday.

13 MS. GILBRIDE: I believe that is correct. I actually  
14 anticipated -- to correct you since we're on this topic, I  
15 think the \$2.9 million as of Friday does include the Thomas H.  
16 Lee fees.

17 THE COURT: It does. Well, as far as the defendants  
18 represented by Ms. Kim and Mr. Goodman, the ones represented by  
19 Baker & Hostetler, I gather that that was about  
20 \$300,000.00/\$307,000.00; is that right?

21 MS. GILBRIDE: That's correct, Your Honor.

22 THE COURT: And I'm taking that away for the record  
23 in the district court?

24 [Pause in proceedings.]

25 MS. GILBRIDE: Oh, as of the earlier hearing, Your



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1 Honor.

2 THE COURT: Right.

3 MS. GILBRIDE: Not as of today.

4 THE COURT: Right. No, I understand.

5 MS. KIM: Your Honor, the \$307,000.00 was as of  
6 August 30th for the five officer defendants that moved as of  
7 that day.

8 THE COURT: All right. All five of them?

9 MS. KIM: All five, not just the Baker, Hostetler --

10 THE COURT: So that's not just Baker & Hostetler but  
11 all five.

12 MS. GILBRIDE: All five of the moving parties; right.

13 THE COURT: All right. Do we know how much is for  
14 the movants today in the aggregate? The three?

15 MR. EISEN: Your Honor, I --

16 THE COURT: Well, no, no, no, let me hear the answer.

17 MS. GILBRIDE: Your Honor, my understanding is as of  
18 yesterday for just these moving parties it's \$2.9 million.

19 THE COURT: Just them?

20 MS. GILBRIDE: Just them.

21 THE COURT: Just these three?

22 MS. GILBRIDE: Yes, Your Honor.

23 MS. MOSES: Your Honor, Barbara Moses, Your Honor,  
24 for Robert Trosten.

25 THE COURT: Well, let me make sure -- there's some

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1 conferring going on over here.

2 [Pause in proceedings.]

3 THE COURT: Just these three?

4 MS. GILBRIDE: Yes, Your Honor.

5 THE COURT: And how much as of the date that I  
6 ordered the -- would you have this number as of the date that I  
7 ordered the payment for the five represented --

8 MS. GILBRIDE: Yes. Yes, that would be \$1.6.

9 THE COURT: \$1.6.

10 MS. MOSES: These are the three numbers for us.

11 THE COURT: Okay. But that would be just for these  
12 three --

13 MS. GILBRIDE: Yes, Your Honor.

14 THE COURT: -- as of the date of the earlier order  
15 that I entered?

16 MS. GILBRIDE: Correct. As of August 31st; right.

17 THE COURT: Okay. Go ahead.

18 MS. MOSES: I apologize, Your Honor. I was  
19 conferring with Mr. Eisen and I missed your last exchange with  
20 Ms. Gilbride. This is Barbara Moses speaking on behalf of  
21 Robert Trosten. But we, the three movants before the Court  
22 this morning, have added up our numbers among ourselves and  
23 they don't add up to \$2 million.

24 THE COURT: Well, okay. I asked Ms. Gilbride two  
25 questions; one was as of the most recent date and that was \$2.9

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1 and I understood and then I asked as of August 31st which was  
2 the date of my earlier order and that was \$1.6 million. Have  
3 you broken it out that way too?

4 MS. MOSES: Well, my understanding, Your Honor -- and  
5 co-counsel for today's moving parties will correct me if I am  
6 wrong -- but my understanding is that as of August 30th the  
7 three plaintiffs who are before you today had submitted bills  
8 totaling -- I'm doing this in my head so bear with me while I  
9 round -- approximately \$940,000.00 or maybe \$950,000.00.

10 THE COURT: Okay.

11 MS. GILBRIDE: We received substantial bills just  
12 yesterday from --

13 THE COURT: No, we're just focusing right now --

14 MS. MOSES: Right. That was the August 30th figure.

15 MS. GILBRIDE: Okay. From Kramer, Levin.

16 THE COURT: -- as of August 31st.

17 MR. EISEN: Yes, that was included.

18 MS. GILBRIDE: Okay.

19 [Pause in proceedings.]

20 THE COURT: So you include bills that cover the  
21 period through August 30th in that \$950,000.00 number?

22 MS. MOSES: Your Honor, I'm going to apologize and  
23 correct myself on the record. Mr. Eisen tells me that my  
24 figure was incorrect.

25 THE COURT: Okay. So is it as of August 31st it's

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1 really \$1.6 million?

2 MR. EISEN: It's \$1.6 million to \$1.7 million, Your  
3 Honor.

4 THE COURT: Okay.

5 MS. GILBRIDE: That's the same number we have.

6 THE COURT: Okay.

7 MR. EISEN: Then just so I'm clear if I may ask Axis  
8 through the Court it then goes up to \$2.6 as of Friday when the  
9 papers were filed according to Axis' motion at Page 30,  
10 Paragraph 65, as of Friday, September 7th, Axis had defense  
11 bills with a value of over \$2.9, of this amount \$307 was  
12 subject to the Court's August 31st order so \$2.9 minus \$300 is  
13 \$2.6 and then as of the weekend and yesterday it is up to \$2.9.

14 THE COURT: Okay.

15 MS. GILBRIDE: Yes,

16 THE COURT: And what is that for? September?

17 MR. EISEN: No, Your Honor.

18 THE COURT: Is that the difference is September?

19 MR. EISEN: No. With the Court's leave I will  
20 explain the pipeline issue.

21 The firms have time going back to June that is in  
22 these bills because of the way they're billed at the end of the  
23 month.

24 THE COURT: Okay.

25 MR. EISEN: So you have June time, you have July time

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1 and how you have August time coming in because August has  
2 closed and the bills for August issue at the beginning of  
3 September. From the perspective of the criminal defendants --  
4 and I don't believe that the other moving insureds who sought  
5 advancement and whose motion we previously joined disagree.  
6 What we would like to request the Court to do is to enter an  
7 order that would be -- really, the words of which would be  
8 identical to the order that was entered last time other than  
9 the caption and the introductory paragraph which would provide  
10 that the bills should be paid through the date of the order  
11 subject to the proviso that nothing in the order effects the  
12 priority of payments because, you know, none of us wants -- we  
13 recognize as the Court noted previously that it is a narrow  
14 ruling confined to the obligation to advance that does not get  
15 into other issues. I would only add that in terms of the  
16 equities or the harms to have -- we are already going to be  
17 carrying September time while we wait for the issue to be  
18 resolved. We are at the point of having to undertake as is  
19 obvious from the bills very substantial work to get ready for  
20 trial which is in March and I really think it goes to the  
21 spirit and the letter of the cases to -- obviously, I'm not  
22 asking the Court to issue an injunction that carries forward.  
23 I recognize that there's going to be a motion for summary  
24 judgment heard in October but in order to avoid disruption it's  
25 important to have some lessening of the liabilities hanging

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1 over the clients in the pipeline and the other movants agree  
2 with that provided the language is inserted about the priority  
3 of payments.

4 THE COURT: Well, let me make sure I understand that.  
5 I mean I can certainly see them making the argument that they  
6 moved first for an injunction and I approved -- ordered the  
7 payment of the defense costs through the date of the earlier  
8 order so they're in essence now a week or so behind and that  
9 may be a meaningful week because of month-end billing and so  
10 you're saying they don't oppose your sort of jumping ahead by  
11 that extra billing?

12 MR. EISEN: Your Honor, I think they would ask that  
13 that be reciprocal that it also apply to them so the -- and I  
14 think that that is --

15 THE COURT: Well, let me hear from. They're standing  
16 up behind you so --

17 MR. KLINE: Your Honor, Ivan Kline from Friedman,  
18 Wittenstein for two of the other movants, Mr. Sexton and Mr.  
19 Shearer. I know I'm speaking also for Mr. Silverman. I  
20 believe -- because we joined in the same comment with Baker &  
21 Hostetler -- our position is that it should be limited to the  
22 same date, August 31st or August 30th, whichever it was --

23 THE COURT: The date of that order.

24 MR. KLINE: And they should not be jumping ahead and  
25 let's be realistic, a bill sent for August time on September

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1 8th is really not due now in any event and lawyers all the time  
2 carry their bills for thirty days. We didn't get payment from  
3 U.S. Specialty or Lexington in, you know, a week after the  
4 bills were submitted and in all fairness, understanding the  
5 situation they're in is really -- we could all wait until  
6 October 12th for the bills that are being sent out in  
7 September. That is our position and that this order should not  
8 go beyond the same August 31st cutoff under any circumstances.

9 THE COURT: All right. Ms. Kim, is that the view for  
10 your clients as well?

11 MS. KIM: Yes, Your Honor. However, if you are  
12 inclined to grant that as of this date --

13 THE COURT: No, I understand.

14 MS. KIM: Then, of course, we'd want to be brought to  
15 the same and not falling behind, Your Honor. That's all.

16 THE COURT: Right. Okay. All right.

17 MR. EISEN: Your Honor, our view is -- and I  
18 apologize, I had understood from my conversation from Ms. Kim  
19 that she was comfortable, in fact I circulated a form of order  
20 that provided today and I had understood that others were  
21 comfortable with that form of order and --

22 THE COURT: Well, as long as they were going to get  
23 pushed up but I phrased my question with the assumption that  
24 they weren't --

25 MR. EISEN: I apologize if I did not understand the

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1 admittedly rushed conversation in the hallway.

2           Your Honor, the criminal defendants, though, would  
3 submit to the Court that there are different exigencies that  
4 apply to our need and if I may the clients will be facing the  
5 prospect of uncertainty as you've heard from Axis very  
6 substantial August bills on top of very substantial September  
7 bills. It's not just the question of Axis having agreed to pay  
8 and waiting a reasonable amount of time for the invoice to be  
9 honored, it is th uncertainty and the precise chilling effect  
10 on the ability to defend the case that the Worldcom Court was  
11 concerned with when it balanced the harms. I do think in  
12 fairness that if the Court were to order this relief that it  
13 ought to apply to the intervening parties as well but the  
14 criminal defendants are really in a unique situation because of  
15 the pendency of the criminal case and it will have a disruptive  
16 effect on the ability to defend that case. They will be  
17 incurring enormous costs and so I would ask the Court in a  
18 balanced way that also recognized the needs of the intervenors  
19 and for that matter of Axis with respect to priority of  
20 payments to enter the order that allows us to limit some of the  
21 back log. We're not insisting that those bills be paid  
22 tomorrow. Axis can take a reasonable amount of time to  
23 evaluate them. I understand that there were some deductions  
24 that they applied to the bills that the others who were before  
25 the Court a little less than two weeks ago submitted and we



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1 don't have any objection to the normal course. What is  
2 difficult for us is to arrive at mid-October carrying millions  
3 of dollars in fees for August and for September not knowing  
4 whether our clients are going to be able to defend the criminal  
5 case. We think that the case law provides guidance to the  
6 Court that in those circumstances it is appropriate to award  
7 those fees and, frankly, the context is not irrelevant. We  
8 believe that Axis -- well, I certainly won't rehash the  
9 argument -- we think that Axis should have advanced these fees.  
10 The first two layers of insurance did advance the fees, we've  
11 been in this position of jeopardy for some time and, you know,  
12 Axis could have avoided today by, once the Court made its view  
13 of the law and the facts clear, agreeing to advance fees we  
14 would not be here. So to some extent Axis has proceeded at its  
15 peril. We think that that raises issues about the good faith  
16 of the insurer but that at any rate it is fair and right and  
17 equitable for the criminal defendants to have the pipeline  
18 lessened somewhat.

19 THE COURT: Do you or the other two movants have any  
20 factual showing that you want to make in respect of the issue  
21 of whether in no particular order if I ruled or whatever Court  
22 had jurisdiction over this matter ruled against them ultimately  
23 that they could reimburse the money advanced? That would be  
24 one issue. The other issue is their ability to pay currently  
25 themselves and, I guess, the third issue is as to the defense

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1 counsel's willingness to proceed with this issue hanging over  
2 them or do you intend to rely on the logic that Judge Cote set  
3 forth in Worldcom?

4 MR. EISEN: Your Honor, I'll take those --

5 THE COURT: In no particular order.

6 MR. EISEN: -- in no particular order. I think there  
7 are two guiding precedents; one is the Worldcom case on your  
8 first question and the other is this Court's decision two weeks  
9 ago and this is the exact argument that the insurers made in  
10 Worldcom. I'll just read from the opinion at 469 to 470,  
11 "Continental and Twin City argue that Roberts has failed to  
12 show irreparable injury because he has not shown that he is  
13 unable to retain counsel from his own funds" and then later on  
14 the Worldcom Court also addresses the argument about  
15 reimbursement and the Court says, the issues here surmount  
16 whether an individual director has or does not have sufficient  
17 funds to pay counsel when confronted with litigation stemming  
18 from services of a corporate director. In some cases it will  
19 be minor, here it is massive, in some cases a director will  
20 have great personal wealth, in other cases she will not. The  
21 issue here is whether every director is protected by a policy  
22 to have the ongoing payment of defense costs. So we think that  
23 Worldcom -- that that's the wrong question under Worldcom.  
24 This is a -- as the Court noted at 87 to 88 of the transcript,  
25 this is a massive litigation. As demonstrated the Court has

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1 the evidence about the size of the bills, it has the evidence  
2 about the pending civil cases that it relied on when we were  
3 last before the Court. It certainly is aware of the pending  
4 criminal cases and, respectfully, Your Honor, we think that the  
5 case law does not require that question to be answered and for  
6 the same reason that the Court advanced previously it's  
7 appropriate to do so as of today or if the Court -- really, as  
8 of today as to all the insureds. We're not asking for special  
9 treatment. It really is to all the insureds and we wouldn't be  
10 here but for Axis' refusal to do that. Indeed, for their  
11 refusal to do something less.

12 THE COURT: Okay. What about the other two  
13 defendants on that particular question?

14 MS. MOSES: Thank you, Your Honor. Barbara Moses for  
15 Mr. Trosten.

16 I concur in Mr. Eisen's remarks. I would also point  
17 out that by asking the question together, by coupling the two  
18 questions of ability to pay defense costs currently and ability  
19 to repay in the event the case ultimately is determined  
20 differently, I think Your Honor may have fallen into, perhaps  
21 just on a testing the waters basis, what's really a Catch-22  
22 that the carrier would like to set up. On the one hand, they  
23 have urged Your Honor and Your Honor rejected this on August  
24 30th, correctly we believe, on the one hand they urged Your  
25 Honor to require the insureds to prove that they are broke in

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1 order to get the advancement to which they are contractually  
2 entitled but then in the next breath they have urged Your Honor  
3 to rule that if the insureds are broke relief should be denied  
4 because they will be at risk of non-repayment should the case  
5 turn out adversely later in the day. It seems to me, Your  
6 Honor, that common sense and ordinary principles of equity tell  
7 you that they can't have it both ways. With respect to the  
8 ability to repay, let me make the following, I think, also  
9 common sense comment which is that the ability of an insured  
10 who is facing criminal charges and is subject to a pre-trial  
11 asset freeze order to repay at the conclusion of the criminal  
12 trial depends in large part on how that trial comes out. Now,  
13 Axis, I think, would like for my client and the other criminal  
14 defendants to lose their criminal trial because they will then  
15 use that in the coverage dispute but with respect to the  
16 ability to repay I say to you that we need the defense costs  
17 now in order to insure that the criminal trial comes out in  
18 favor of our clients which in turn has a bearing on the ability  
19 to repay at the end of the day.

20 THE COURT: Okay.

21 MR. GOLENBOCK: Your Honor, Jeffrey Golenbock for Mr.  
22 Bennett.

23 I would like to rely on the arguments that have been  
24 made by my colleagues. I don't think I need to add anything  
25 further. I'll, of course, answer any questions Your Honor may

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1 have.

2 THE COURT: Okay. Thank you.

3 Ms. Gilbride.

4 MS. GILBRIDE: Your Honor, the first thing I'd just  
5 like to note for the record is that we have gone ahead as  
6 suggested by Your Honor during the August 30th hearing and made  
7 a motion to withdraw the reference. I think it is important  
8 for the Court to be aware of that. Perhaps you are already  
9 aware of that.

10 THE COURT: I was. Yes.

11 MS. GILBRIDE: Okay. That motion is before the  
12 district court. We're not quite sure where we are procedurally  
13 with that so I can't report back where we are and when there's  
14 going to be a hearing. We have certainly asked that there be a  
15 hearing expeditiously. I believe that there will be but we  
16 face substantial opposition from the insureds with respect to  
17 going that route as suggested by Your Honor on August 30th.

18 In any event, I don't believe we're here today in the  
19 same posture that we were here on August 30th. First of all,  
20 the three moving parties here today initially moved to dismiss  
21 Axis' complaint. They joined in that motion. That motion was  
22 granted by Your Honor. They have now turned around and  
23 instituted an adversary proceeding seeking the same relief  
24 sought by other moving parties and, Your Honor, I would suggest  
25 that that is just fundamentally unfair and an abuse of the

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1 legal system by these moving parties.

2           Additionally, Your Honor, these three defendants are  
3 not in the same posture on any test, particularly, one of the  
4 three moving parties as the moving parties on August 30th who  
5 requested the preliminary injunction. One of these parties is  
6 the individual who signed the warranty letter that Axis relied  
7 upon. He's the individual who signed the application, he's the  
8 individual whom the company disclosed in an SEC filing three  
9 days after -- excuse me, shortly after the company went public  
10 that he had hidden \$430 million worth of receivables. Well,  
11 that was information that Axis relied upon as well. So, Your  
12 Honor, I submit we are not in the same position that we were in  
13 on August 30th.

14           With respect to the preliminary injunction, Your  
15 Honor, I apologize first of all that we did not attach the  
16 Gaone transcript. It's not a published decision. It's a  
17 transcript. It was before Your Honor on August 30th. It was  
18 submitted by Arch, who sought to intervene on that day. In any  
19 event, we'd be happy to hand up a copy to Your Honor but you've  
20 already made it clear that you're not going to rule upon it.  
21 This preliminary injunction was brought on very quickly as Your  
22 Honor is aware and we apologize, again, for not submitting that  
23 but I would strongly urge that the Court consider the  
24 propositions that were articulated in that ruling which  
25 essentially our position is that what Judge Wood did was simply

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1 apply Second Circuit case law which is clear that if you're  
2 going to apply the lower standard for injunction there has to  
3 be a balancing of harms. There's been no factual record made  
4 before this Court; not one affidavit, not one individual has  
5 come here to testify before Your Honor with respect to the  
6 irreparable harm that they have allegedly suffered. There is  
7 no factual record before Your Honor and I submit under Second  
8 Circuit law that is simply fatal to an application for a  
9 preliminary injunction.

10           Going to the balancing of harms, Your Honor, you  
11 know, on the one hand you have individuals who have made no  
12 factual showing whatsoever but who have come before Your Honor  
13 and said that their defense is going to be devastated because  
14 their defense counsel is not paid. Well, I submit that that  
15 should have been submitted to Your Honor in factual form.  
16 There should have been evidence submitted to your Court of that  
17 not counsels' statements. But in any event, so there's no  
18 factual showing.

19           On the other side of the coin you have an insurance  
20 company who has a policy provision that says if we are  
21 ultimately successful we are entitled to repayment. The  
22 movants are here on a preliminary injunction. Rule 65 provides  
23 the answer to all of these questions. If the Court is inclined  
24 to grant the preliminary injunction, Your Honor, we would  
25 suggest that the Court require the moving parties to post a

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1 bond or some form of security so that in the event some court  
2 agrees with Axis' position and finds that we have been  
3 wrongfully enjoined that there is then some security for Axis  
4 with respect to repayment. Otherwise, Your Honor is advancing  
5 something -- advancing relief to these parties on a very  
6 preliminary basis without a full-blown hearing, with Axis'  
7 complaint having been dismissed. So with Axis not having the  
8 ability to present its arguments in any shape or form and not  
9 even requiring a factual showing by the parties and, you know,  
10 Your Honor, we would submit under those circumstances at the  
11 very least that the Court order these moving parties to post  
12 some form of security in the event that Axis is successful.

13           You know, under the circumstances it's clear that  
14 Axis has zero prospect of being repaid if at the end of the day  
15 Axis is actually successful in whatever form we are able to  
16 actually litigate our dispute.

17           With respect -- I don't know if you want to get into  
18 the priority of payments issue, Your Honor, the issue we have  
19 there is that separate and apart from defense costs there has  
20 been an executed MOU submitted to Axis and as of today if some  
21 court ultimately finds that there is actually coverage under  
22 the policy and we are required to fund that settlement -- if  
23 the Court says we should have considered that settlement as of  
24 the date the settlement was executed, Your Honor will be  
25 ordering us to advance defense costs in excess of our policy



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1 limits. Now, we are not at liberty to share that MOU with you  
2 but --

3 THE COURT: But you aren't paying under the MOU;  
4 right? Your clients aren't making a payment. It's disputing  
5 the coverage, I think.

6 MS. GILBRIDE: Well, we've been asked to fund the  
7 settlement.

8 THE COURT: I know but you're not paying it.

9 MS. GILBRIDE: I don't know that any determination  
10 has been made. Whether we are going to fund it or not has not  
11 come to fruition.

12 THE COURT: But I thought that Axis disclaimed  
13 coverage?

14 MS. GILBRIDE: Well, we did, Your Honor, but you  
15 know, there's a moving target in terms of what the Court is  
16 ordering us to do here.

17 THE COURT: Well, but all I'm saying is the  
18 individual -- I'm assuming it's an individual -- who submitted  
19 the proposed settlement hasn't sought relief to compel payment;  
20 right?

21 MS. GILBRIDE: Not yet.

22 THE COURT: Okay. So how does requiring payment of  
23 the defense costs to somebody who hasn't sought that relief and  
24 I'm assuming that anyone whose the beneficiary of their policy  
25 knows that if this litigation is going on and would make the

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1 same application that if they really wanted to enforce it but  
2 hasn't. How does my ordering the -- if I were to do it -- the  
3 advancement of the defense costs put the insurer at a  
4 disadvantage?

5 MS. GILBRIDE: Your Honor, historically, the defense  
6 costs have been reimbursed by the two underlying carriers on a  
7 first in/first out basis. So if one was to consider the  
8 settlement as of the date it was executed in that line of  
9 payments and we do ultimately -- we are required to fund the  
10 settlement -- by advancing these defense costs now we could  
11 theoretically or we would be asked -- we are being put in a  
12 position where we potentially are paying fees --

13 THE COURT: Well, when was the MOU submitted?

14 MS. GILBRIDE: When was it executed? August 30th.

15 THE COURT: Well, what --

16 MS. GILBRIDE: Well, it was signed on August 30th.

17 THE COURT: But when was it submitted to the insurer?

18 MS. GILBRIDE: July 30th.

19 MR. EISEN: No.

20 MS. KIM: Yes, July 30th.

21 MR. EISEN: The MOU submitted --

22 THE COURT: But it was signed after it was submitted?

23 MS. KIM: Your Honor, may I address that issue?

24 THE COURT: Okay.

25 MS. KIM: Helen Kim on behalf of Mr. Klejna, Your

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1 Honor. The MOU which was a settlement demand from the lead  
2 plaintiffs in the underlying securities litigation in In Re:  
3 Refco securities litigation was submitted to Axis on July 30th  
4 on the date it was received by Mr. Klejna.

5 THE COURT: Okay.

6 MS. KIM: With a request to Axis to assist in the  
7 settlement and to --

8 THE COURT: To assist but as far as a settlement  
9 itself, when was that submitted as a settlement?

10 MS. KIM: Well, we requested Axis to join the  
11 negotiations because they have an obligation under the policy  
12 to consent to settlement.

13 THE COURT: All right. But as far as an obligation  
14 to pay money in respect of a settlement --

15 MS. KIM: Well, Your Honor, it is our position that  
16 Axis has an obligation, once it's presented with a signed  
17 settlement agreement, to either consent or not consent and so  
18 it has to set aside money for a settlement if it consents.

19 THE COURT: I'm sorry, it wasn't signed when it was  
20 submitted to them in July; right?

21 MS. KIM: Not on July 30th but after --

22 THE COURT: It was signed at the end of August;  
23 right?

24 MS. KIM: It was signed on August 30th after Axis  
25 gave us -- told us to proceed as a prudent uninsured and to

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1 proceed accordingly.

2 THE COURT: Okay. So wouldn't that be the relevant  
3 date then?

4 MS. KIM: August 30th; correct, Your Honor.

5 THE COURT: Okay.

6 MS. KIM: So what we're saying is -- and this goes to  
7 the issue of priority of payments -- as long as any order on  
8 the preliminary injunction does not interfere with the priority  
9 of payments under the terms of the Axis policy we don't believe  
10 that there's a problem.

11 THE COURT: Okay. How would it interfere? Say I  
12 were to require payment of these three individual defense costs  
13 as of the date of my order which, I forget, was that either  
14 August 30th or 31st?

15 MS. GILBRIDE: The 31st.

16 THE COURT: How would it interfere with this separate  
17 potential obligation?

18 MS. KIM: It would not, Your Honor.

19 THE COURT: Well, no, I was asking Ms. Gilbride.

20 MS. KIM: Oh, I'm sorry.

21 MS. GILBRIDE: If you were to order today as of  
22 August 31st?

23 THE COURT: Yes.

24 MS. GILBRIDE: We're just trying to look at the  
25 numbers and figure this out. We were anticipating that Your

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1 Honor might be inclined to award advancement of defense costs  
2 as of today.

3 THE COURT: No, well, that wasn't my question.

4 MS. GILBRIDE: Okay. I know. So I don't have the  
5 answer readily available. I apologize.

6 MS. KIM: If it's \$2.1 million as of August 31st  
7 which were the numbers that we discussed earlier there would be  
8 nothing, Your Honor. No interference whatsoever.

9 THE COURT: All right.

10 MS. GILBRIDE: Your Honor, I think that if it was as  
11 of August 31st I agree that we would still be within the policy  
12 limits.

13 THE COURT: All right. I'm not saying that that's  
14 where I'm going on this. I'm not saying that's -- no one  
15 should read this as a determination of any allocation or  
16 priority issues.

17 MS. KIM: We understand, Your Honor.

18 THE COURT: It's just that we're trying to figure out  
19 the facts.

20 MS. KIM: That's right, Your Honor, and we agree with  
21 Your Honor.

22 MR. EISEN: Your Honor, were the Court to decide to  
23 enter the identical order as last time effective as of today,  
24 the date of the order, it could also address this issue by  
25 simply including the sentence that Ms. Kim requested. We and

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1 Ms. Kim's clients agree on that that this order does not effect  
2 the priority of payments in any way.

3 THE COURT: Well, I know that an order can say that  
4 but as a practical matter it might wouldn't it?

5 MR. EISEN: No, Your Honor, we think it would not  
6 because the insurer is perfectly capable, as they've  
7 demonstrated, of taking positions on the legal issues. The  
8 priority of payment issue is, we think, a Mankwait issue. The  
9 settlement has not been presented much less approved. They  
10 could certainly pay up to the limits without any risk.

11 THE COURT: Well, no, let me -- as I understand Axis'  
12 point, it's this, that although they have disclaimed coverage  
13 ultimately they might have to pay on the settlement and since  
14 the settlement came in as of a date that preceded some of these  
15 bills, you know, the ones in September they would be paying  
16 these bills -- the post-September bills -- potentially out of  
17 sequence, first come/first serve. Now, maybe that's not right,  
18 maybe that priority doesn't depend on first come/first serve  
19 necessarily but that's their point.

20 MR. EISEN: Your Honor --

21 THE COURT: And they wouldn't have any ability  
22 necessarily to get it back or reallocate it necessarily.

23 MR. EISEN: Your Honor, the issue is clouded because  
24 the amount of the settlement is unknown. However, I can  
25 represent to the Court based on conversations with various

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1 persons attempting to determine, you know, would you pay the  
2 bills as of the beginning of September, mid-September, so on  
3 and so forth, that the -- we believe it would be possible to  
4 without implicating the priority of payments issue at all to  
5 pay the bills through Friday but, again, there is a safe harbor  
6 for this which is simply to provide in the order to have us  
7 agree that pending the resolution in October the insurer only  
8 needs to pay up to the amount of the settlement. If, for  
9 example, the settlement is \$6.5 million --

10 THE COURT: No, I understand your point. All right.  
11 So that would be a cap --

12 MR. EISEN: That is a way to accommodate the harms  
13 that the criminal defendants are facing and at the same time  
14 give Axis a safe harbor.

15 THE COURT: Okay.

16 MS. MOSES: May I add a word, Your Honor, on the  
17 priority of payment issue? A word which is, I think,  
18 particularly appropriate given Ms. Gilbride's comments  
19 concerning consistency in litigation position.

20 We were required to initiate a new adversary  
21 proceeding and to submit a pleading -- an adversary complaint -  
22 - demanding payment of our defense costs in an ongoing schedule  
23 in order to properly put this issue before Your Honor and be in  
24 a position to ask Your Honor for a preliminary injunction for  
25 that relief. The settlement issue has never been teed up in

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1 any pleading. So, clearly, whether the Court has if you will  
2 jurisdiction to rule on it at this point --

3 THE COURT: Well, I don't think they're asking me to  
4 rule on it, I think they're saying that as far as the balance  
5 of the harms go is I should take it into account.

6 MS. MOSES: Well, second, Your Honor, Ms. Gilbride  
7 has also asked Your Honor where's the evidence and has in  
8 effect asked Your Honor to ask us for evidence of financial  
9 condition but, again, there has been no evidence presented to  
10 Your Honor of the settlement or its amount or any of its  
11 particulars and, third, Your Honor, as we all know we have not  
12 had an opportunity to brief this point but as we all know from  
13 having practiced in federal court and under Rule 23 any  
14 settlement in In Re: Refco would have to be approved both  
15 preliminarily and finally after a notice and comment period by  
16 Judge Lynch before it would be binding on anyone.

17 THE COURT: Okay.

18 MR. EISEN: Your Honor, in addition to the very last  
19 point that Ms. Gilbride made, I do think that we and Ms. Kim's  
20 client and the other insureds agree that that language that she  
21 suggested to the order that this does not effect the priority  
22 of payments would allow the insurer to pay up to what's  
23 available and then provide a safe harbor for the test.

24 May I very quickly be heard on Ms. Gilbride's other  
25 points?



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1 THE COURT: Well, I hadn't finished asking her  
2 questions.

3 MR. EISEN: Okay. I'll sit down.

4 THE COURT: You can be briefly but after I -- I want  
5 to go back over something that we spent a lot of time on the  
6 last hearing, the interpretation of the provision of the U.S.  
7 Specialty policy that says the insurer will pay covered defense  
8 costs on an as incurred basis and as I understand it Axis'  
9 argument is that these defense costs aren't "covered" under the  
10 policy?

11 MS. GILBRIDE: Yes, Your Honor.

12 THE COURT: But is that based simply on the  
13 exclusions?

14 MS. GILBRIDE: Yes. It's based upon the warranty and  
15 --

16 THE COURT: Well, the warranty is not part of the  
17 policy is it?

18 MS. GILBRIDE: Well, it becomes part of the policy  
19 and it provides for its own remedy, Your Honor. It becomes an  
20 exclusion by its own terms. At the bottom of the warranty it  
21 provides that it becomes part of the policy and becomes an  
22 exclusion and it does not require any filing of adjudication of  
23 facts, it simply requires that Axis in good faith make a  
24 determination whether it applies to the facts before it and  
25 determine whether or not there's coverage.

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1 THE COURT: Well, now you're moving away from the  
2 warranty, too, the overall argument?

3 MS. GILBRIDE: No, I was just saying what the remedy  
4 is that the warranty provides.

5 THE COURT: Okay. All right.

6 Then I guess my other question on this same contract  
7 issue is you point to the following paragraph, Paragraph 3,  
8 which is dealing with the allocation of losses covered and  
9 losses not covered and say that that's further indication that  
10 the insurance carrier was given the authority under this  
11 contract to act unilaterally if it wasn't able to agree and my  
12 question is, I guess, why go through that distinction at all in  
13 three if coverage pertains already? Why isn't that just a  
14 separate provision dealing with allocation? I mean if -- as I  
15 take it your first argument is you can act unilaterally as to  
16 whether something is covered or not. Why would the parties  
17 then have a whole separate provision that would say the same  
18 thing?

19 MS. GILBRIDE: Your Honor, we pointed to condition  
20 (d)(3) simply as evidence that the entire policy should be  
21 construed in context. So our position is not that you should  
22 go to (d)(3) with respect to this dispute, we rely solely with  
23 respect to this dispute on (d)(1) but we rely upon (d)(3) as  
24 evidence to be in support of our position under (d)(2), (d)(3)  
25 is a provision that you actually utilize when there's covered

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1 and uncovered claims. So Your Honor is absolutely right that  
2 you would not utilize (d)(3) in this dispute. We were simply  
3 pointing it out to show that it is consistent with Axis'  
4 interpretation of (d)(2). Our position is that (d)(2) says in  
5 the first instance if defense costs are not covered if the  
6 policy is not triggered then Axis, acting in good faith, of  
7 course, would not have to advance defense costs.

8 THE COURT: Okay. Thanks.

9 MR. EISEN: Your Honor, I'll take them in order and I  
10 will attempt to be brief.

11 Ms. Gilbride's first point was that after joining in  
12 the motion to dismiss for us now to seek advancement is an  
13 abuse. As the Court well remembers, we did not just join in  
14 the motion to dismiss, in the alternative we also joined in the  
15 motion to advance and in response the Court asked us to take  
16 procedural steps. We've done that. We've been crystal clear  
17 throughout that we believe there's a legal obligation to  
18 advance so I think there's no inconsistency there.

19 In terms of the factual record issue, I really would  
20 point the -- she first makes the point about irreparable harm  
21 and then about the balance of the harms. Our factual showing  
22 is exactly the same factual showing that the other moving  
23 insureds made. It's exactly the same factual showing on both  
24 of those points as was approved in Worldcom so I think that  
25 this is an argument that was made and that was rejected and

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1 that does not --

2 THE COURT: Well, I guess the only distinction there  
3 is there seemed to be agreement between the parties last week  
4 that the five Ds and Os that were covered by the injunction  
5 last week were fairly well-healed and I mean that was a point  
6 that Axis made and no one really disputed it and that doesn't  
7 go to the point of irreparable harm but it does go to their  
8 other point about ability to reimburse and I understand your  
9 colleague's point about the Catch-22 or a Hobson's Choice but I  
10 think that may be a distinction between last week's record and  
11 today's.

12 MR. EISEN: Your Honor, I do think it is clear in the  
13 Worldcom case that given the volume of the defense costs here -  
14 - for example, as the Court knows in the KPMG criminal  
15 litigation there was recently fact-finding by the district  
16 court about what it costs to defend these cases. Given the  
17 volume the precise -- you know, it is a harm on anyone and that  
18 that factual showing is not required, we think, under the case  
19 law.

20 I would also -- it goes to, I guess, Ms. Gilbride's  
21 repeated statements both here today and in the brief that  
22 there's zero prospect of repayment. That really turns the  
23 presumption of innocence on its head. We believe the clients  
24 will be acquitted. We're looking to the Court for the interim  
25 time so that we can keep working in September and at the

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1 beginning of October towards that goal and to presume that --  
2 and Ms. Gilbride's conclusion really turns the legal  
3 presumption on its head -- we think that she's made the wrong  
4 analysis and she has not shown that there is zero prospect of  
5 repayment and, of course, I think zero prospect is an  
6 overstatement.

7           On the priority of payments issue we've already made  
8 the point that there is a solution which is to include the  
9 language and then the interpretation issues, we think, have  
10 already been decided by the Court and those are queued up for  
11 summary judgment so I won't speak to those now unless the Court  
12 wishes me to.

13           THE COURT: Okay. Anyone else?

14           MR. CASHMAN: Your Honor, may I be heard for one  
15 moment?

16           THE COURT: Yes. Sure. I'm sorry, which one of  
17 these movants do you represent?

18           MR. CASHMAN: I represent defendant Philip Silverman.  
19 He was among those who received the benefit of Your Honor's  
20 preliminary injunction last week.

21           THE COURT: Okay.

22           MR. CASHMAN: I just wanted to underscore, Your  
23 Honor, that I do not believe the issue of priority of payments  
24 is appropriately before Your Honor this morning. I think I  
25 would be remiss being here today, having listened to all these

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1 arguments, if I did not simply point out to Your Honor that  
2 there are various conflicting interests among the insureds that  
3 would have to be assessed in connection with any priority of  
4 payment argument that were made and so I think the only issue  
5 that ought to be addressed here today is simply whether or not  
6 defense costs should continue to be advanced at the request of  
7 the moving defendants here and through what date, I think.  
8 Those are the only issues that need to be addressed and ought  
9 to be addressed because all the other issues are complicated  
10 and raise varying issues that are not before you today and the  
11 policy itself does not offer a simple solution to those issues.

12 THE COURT: Okay. Well, let me hear somebody who  
13 hasn't spoken yet.

14 MR. WILOMOWSKY: Good morning, Your Honor. Steven  
15 Wilomowsky of Bingham, McCutchen, LLP on behalf of RJM, LLC,  
16 the plan administrator.

17 Your Honor, I just want to make a point on the record  
18 with regard to this motion because the tie-in that brings these  
19 parties to this Court is the lift stay aspect, is obviously the  
20 Refco aspect, but it does not follow necessarily that if the  
21 Court's analysis that led to the lifting of the automatic stay  
22 to the extent applicable for the other defendants necessarily  
23 applies to the movants that are here today and the reason is,  
24 Your Honor, the movants today, particularly Mr. Bennett and Mr.  
25 Trosten, have not filed proof of claim against the estates.

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1 Mr. Grant, also, he did file a proof of claim. His claim has  
2 been estimated at zero dollars for all purposes including  
3 distribution.

4 To the extent that in considering today's motion Your  
5 Honor, taking into account impact on the estate, I think that  
6 there is a difference between just, for example, Mr. Klejna,  
7 who does have a claim filed against the estate and then,  
8 presumably, even though that hasn't been litigated or allowed  
9 or disallowed yet but at least it's a claim that's there that  
10 potentially that any recoveries that they are able to get out  
11 of Axis or any other insurer is going to serve to reduce the  
12 claim against the Debtor's estates, whereas, with respect to  
13 the recoveries, for example, that may be achieved by Mr.  
14 Bennett, the only thing that's doing is really reducing  
15 availability of insurance proceeds for other people who do have  
16 claims and whose claims would be reduced if they were able to  
17 receive insurance proceeds.

18 So we haven't taken a position in this litigation,  
19 it's been until now, certainly, it hasn't been -- early on in  
20 the cases there had been some involvement, we had been involved  
21 with Lexington and it's been a close call among the plan  
22 administrators whether to -- this whole process is an expensive  
23 one and it's been a very time-consuming litigation for the  
24 parties here and so we've been reluctant to get involved since,  
25 ultimately, there are no dollars -- there are no actually

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1 dollars that can come out of this policy that can come back  
2 into the estates but we did want to say that to the extent that  
3 Your Honor is reviewing today's motion both in terms of its own  
4 jurisdiction and in terms of the lift stay standards and  
5 elements, we would note that the estate is not going to be  
6 benefitted to the extent that, for example, Mr. Bennett were to  
7 recover from these proceeds.

8 THE COURT: Whether you take Judge Berra's version of  
9 it or Judge Gerber's version of it doesn't Adelphia control  
10 here? I mean there's been -- at this point they're simply  
11 indicted, they're not convicted and under the Adelphia case law  
12 which I think is the most thorough discussion of this issue,  
13 wouldn't they be entitled to the money? Leaving aside issues  
14 of allocation which, again, I don't think I'm going to get into  
15 but assuming that there are no allegation issues, don't they  
16 come first?

17 MR. WILOMOWSKY: Well, two responses to that. First,  
18 to the extent -- if one supposes that the automatic stay is  
19 applicable here and I understand that that could be an open  
20 question --

21 THE COURT: Well, I don't think there's -- people  
22 should stop talking about the automatic stay.

23 MR. WILOMOWSKY: Okay.

24 THE COURT: It's a plan injunction.

25 MR. WILOMOWSKY: Okay.



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1 THE COURT: The confirmation order is really clear on  
2 this in Paragraph 34.

3 MR. WILOMOWSKY: Okay. That's correct, Your Honor.

4 THE COURT: So when people are saying "automatic  
5 stay" I'm translating it in my head --

6 MR. WILOMOWSKY: They mean --

7 THE COURT: -- the plan injunction.

8 MR. WILOMOWSKY: Okay. You got it, Your Honor.

9 THE COURT: So that's what we're talking about.

10 MR. WILOMOWSKY: All right. In response to your  
11 question I think that the differences here is that at least  
12 what Adelphia speaks to is the access that the parties can have  
13 to the policy notwithstanding the fact that they may be under  
14 criminal indictment or whatever their situation might be. I  
15 think it's a separate question as to -- and I may be  
16 misremembering Adelphia but I don't think that there was a  
17 question in terms of the claims or at least the jurisdictional  
18 question, I guess, which is if there is no possible benefit to  
19 the estate then should this be something -- should this Court  
20 be enjoining -- should be requiring this particular result from  
21 Axis when either way there isn't going to be any possibility of  
22 a benefit to the estate even in the form of a reduced claim.  
23 That's the question, I guess.

24 THE COURT: Well, but it, I guess -- okay. Now I  
25 understand your point now. It's a jurisdictional point you're

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1 raising as opposed to a lifting of an injunction point.

2 MR. WILOMOWSKY: I think so, Your Honor.

3 THE COURT: But as far as jurisdiction goes in  
4 addition to the narrow benefit issue isn't there jurisdiction  
5 premised on the fact that the policy itself is property of the  
6 estate and I'm being asked to interpret it and, secondly, the  
7 fact that it's one in a layer of excess coverage and at some  
8 point if the policy is interpreted properly and the facts play  
9 out properly in that layer -- in that sequence of layers the  
10 estate will benefit because there will be insurance that will  
11 pay claims either of Ds and Os or of other claimants -- third  
12 parties -- who were under the plan made the appropriate  
13 election to look to the litigation and obviously the insurance  
14 that is behind the litigation.

15 MR. WILOMOWSKY: I think that's right, Your Honor. I  
16 think though that ironically though the granting of this motion  
17 is more likely -- if you assume -- if we don't present --

18 THE COURT: No, but you see that goes to the merits  
19 as opposed to jurisdiction. I understand but sometimes you  
20 have --

21 MR. WILOMOWSKY: I understand, Your Honor. That was  
22 it. I think I've said enough.

23 THE COURT: Okay.

24 MR. JEROME: Your Honor, may I be heard?

25 THE COURT: Yes.

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1 MR. JEROME: Your Honor, I represent Joseph P. Murphy  
2 along with Baker, Hostetler. Mr. Murphy was an officer of  
3 Refco in charge of marketing and ran the regulated company  
4 which as Your Honor may recall was sold in these bankruptcy  
5 proceedings. Now, Mr. Murphy, as an officer of Refco is  
6 unfortunately embroiled in the various class actions. He was  
7 also a beneficiary of the various insurance policies which are  
8 contested.

9 I think the dark and somewhat unstated fact here is  
10 that as the assets -- and I'm not saying that it shouldn't be  
11 done and that's not appropriate -- but equitably and fairly,  
12 the unhappy fact is that as assets are burned for criminal  
13 defense I have no doubt that the consequence of that will be  
14 that Mr. Murphy will not in fact have enough funds from  
15 insurance proceeds to answer to any judgment that might be  
16 levied against him and I also think he probably will not have  
17 sufficient funds to defend himself in the class actions given  
18 what I know and maybe my knowledge is deficient and Your Honor  
19 knows, sometimes that happens with me, but it may be I'm right  
20 and I think that I am.

21 So in terms of weighing the harm and the equities  
22 here, while I'm not suggesting that the criminal defendants are  
23 entitled to the relief that they seek here I would like to  
24 suggest that there is an opportunity that we have, an  
25 opportunity of constricted time which we have between now and

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1 October 12th when Your Honor will be called upon to make a  
2 decision in respect of the permanent injunction. I would hope  
3 that in that constrained time frame we would, perhaps, resort  
4 to some form of mediation and I know, Your Honor, the other  
5 insurance companies are not before you and I'm certainly not  
6 asking that this Court, although it has the power, to compel  
7 mediation. I'm suggesting that the parties in the interests of  
8 trying to iron out these various issues which will continue,  
9 Your Honor, to come before this Court because each and every  
10 insurance company is going to deny coverage and is going to be  
11 before this Court or some other court arguing this for months  
12 on end. I think that if Your Honor would at least on the  
13 record, while not compelling arbitration, suggest that it might  
14 be a good idea for the parties to engage in between now and  
15 October 12th and in addition to the parties, those other  
16 insurers who are not before Your Honor may at least get a  
17 friendly message which would encourage them to sit down and try  
18 to at least get the process started. I think that the result  
19 of an appropriately negotiated, successful mediation could  
20 result in evening out, I think, some of the tawdry races that  
21 we're witnessing in terms of first come/first serve, have you  
22 gotten your bills in or haven't you and in point of fact, Mr.  
23 Murphy's \$13,000.00 bill for July wasn't filed on time. We  
24 were seven days late.

25 I know we'd like to avoid this and I think mediation,

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1 hopefully, if it could resolve these matters could resolve  
2 this, I think, unseemly race to the insurance courthouse. So,  
3 Your Honor, I would respectfully request that this Court at  
4 least on the record encourage the parties to come to some form  
5 of mediation. I might add that there has been some discussion  
6 between the parties on the subject and I think that some of  
7 them might be favorably disposed to doing so. If some of the  
8 parties fall out and don't want to do it, that doesn't mean  
9 that other parties involved, particularly my client, my shared  
10 client, couldn't benefit from the mediation and in no way,  
11 shape or form, Your Honor, am I suggesting that the mediation  
12 would prejudice these proceedings or interfere with what's  
13 going to happen on October 12th. I am suggesting that we have  
14 a window of time and I would hope that the Court would  
15 encourage us and urge us to resort to mediation.

16 With that, Your Honor, I thank you very much for your  
17 indulgence.

18 THE COURT: Okay.

19 MR. EISEN: Your Honor, I have a couple of very brief  
20 points and then Ms. Moses will conclude on behalf of the  
21 insureds.

22 With respect to counsel for Mr. Murphy's statement,  
23 we wholeheartedly agree. I don't know that it is necessary or  
24 appropriate to be part of an order. I take it there's no  
25 disagreement as with the Debtor's position, they haven't

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1 objected to the relief we seek and we think that the idea of  
2 all sitting down and talking, bringing the other insurers to  
3 the table is a good idea. So, certainly, the movants today do  
4 not need to be ordered to do that. I do think that the  
5 counsel's statement does emphasize the value of issuing an  
6 order as of today that will apply to the payments of these fees  
7 so that this race is not to the disadvantage of some.  
8 Obviously, we think the disadvantage is greater as to the  
9 criminal defendants.

10           On the jurisdictional point that the Debtor raised,  
11 the Court responded more eloquently and knowledgeably than I  
12 can and I would only echo those points by saying, you know, it  
13 really is one dispute that all of the movants are queuing up  
14 for the Court. The Court has already found that it has  
15 jurisdiction and as the Debtor noted, Mr. Grant had filed the  
16 claims, they were disputed.

17           Then, finally, I looked back at whether it was agreed  
18 or not as to the means of the previous movants and in fact it  
19 was hotly contested. Axis made the point very forcefully that  
20 the previous insureds had not made a showing either that they  
21 can't pay or that they can repay and the previous insureds  
22 replied with equal force that that is not the test and I think  
23 the Court will find that the record is completely devoid of  
24 that evidence because under Worldcom and under Your Honor's  
25 holding that showing is not required in a mega case of this

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1 kind and with that I will yield to my colleague.

2 MS. MOSES: Very briefly, Your Honor, and we do  
3 appreciate the time you've devoted to this matter this morning.

4 Mr. Jerome used the term "unseemly" with respect to  
5 the various insureds' request for defense payments. I think  
6 the only thing that can be said about that is that my client,  
7 Mr. Trosten, and the other indicted plaintiffs, Mr. Bennett and  
8 Mr. Grant, did not indict themselves. They did not choose to  
9 be criminal defendants, they are not --

10 THE COURT: Well, I think he was just talking about a  
11 rush to get bills in. I think that's all he meant by that.

12 MS. MOSES: Right.

13 MR. JEROME: That's correct, Your Honor. Thank you.

14 MS. MOSES: With respect to the mediation point no  
15 lawyer wants to be in the position of resisting a suggestion of  
16 mediation and I certainly am not going to put myself in that  
17 position but I do think it is fair to point out that while the  
18 parties can and I hope they will voluntarily discuss a  
19 potential non-litigation solution to this issue between now and  
20 October 12th, nothing that we do between now and October 12th  
21 can stop the clock with respect to the underlying actions,  
22 either civil or criminal, and particularly given Axis' history  
23 of resisting to the very last moment and sometimes beyond and  
24 its demonstrated reluctance to write a check until and unless  
25 it is specifically ordered to do so by this Court, my own view,

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1 Your Honor, is that settlement discussions with an eye towards  
2 possibly a global settlement involving the higher tier carriers  
3 as well will be far more effective and far more likely to  
4 succeed after October 12th if, indeed, that is the date for  
5 summary judgment. Thank you.

6 THE COURT: Okay. Do you have anything to say, Ms.  
7 Gilbride?

8 MS. GILBRIDE: Yes, just very, very briefly, Your  
9 Honor.

10 With respect to the arguments advanced by both  
11 counsel that the Worldcom decision controls somehow whether or  
12 not Your Honor has to consider balancing of harms, I would just  
13 simply submit that the Worldcom court did not consider  
14 balancing of harms in any way, shape or form. It didn't say  
15 that you don't consider it, it simply wasn't considered. There  
16 is Second Circuit authority precisely on point which says that  
17 the balancing of harms must be considered when the Court orders  
18 a preliminary injunction.

19 With respect to the Catch-22 that counsel and Your  
20 Honor are concerned about, respectfully, there is a provision  
21 in the Federal Rules that deal with that precise issue, it's  
22 Rule 65(c) which states that when ordering a preliminary  
23 injunction a Court can and should but has discretion, of  
24 course, order that the party who is being awarded the  
25 preliminary injunction either post a bond or securitize the



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1 amounts being awarded and, respectfully, I think that that  
2 deals with the Catch-22 situation that counsel is referring to  
3 and, perhaps, was meant for just that situation.

4 With respect to the priority of payments issue, Your  
5 Honor, I haven't had a chance to confer with Baker & Hostetler  
6 but if Your Honor so desires a copy of the MOU in camera with  
7 consent of counsel, we'd be happy to submit that to you if you  
8 so desire.

9 I have nothing further. Thank you.

10 THE COURT: Okay.

11 MR. EISEN: Your Honor, could I just respond to the  
12 Worldcom point because it is in the case?

13 THE COURT: No, I read -- I know.

14 I'm going to take a look at Judge Woods' decision so  
15 you can hand that up to me and I'm going to take a break but  
16 before I do that I'm going to deal with the two pre-trials that  
17 I put at the end of the calendar and then I'll come back to you  
18 all probably by -- hopefully, by 12:00 or 12:15 so you can  
19 check your Blackberrys and make some phone calls and I'll be  
20 back around 12:15 or so is my guess with a ruling.

21 ALL ATTORNEYS: Thank you, Your Honor.

22 THE COURT: So if you could hand that up and then  
23 I'll take the American Express v. Rodriguez or Gloria Ramirez.

24 [Off the record.]

25 THE CLERK: Please be seated.

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1           THE COURT: Before the Court is a motion for a  
2 preliminary injunction brought by Messrs. Grant, Trosten and  
3 Bennett in this adversary proceeding in which they are  
4 ultimately seeking a declaratory judgment and permanent  
5 injunction against Axis Reinsurance Company, an excess insurer  
6 that is currently in line in the tier of insurance coverage  
7 obtained by the debtor, Refco, Inc., for its officers and  
8 directors and itself.

9           Procedurally, I should go through the history of this  
10 matter briefly. The first step in respect of this insurance  
11 company or insurance coverage dispute was taken by Axis in  
12 initiating an adversary proceeding against not only Grant,  
13 Trosten and Bennett but the other officers and directors of  
14 Refco, Inc. who have made claims in respect of the policy as  
15 well as Refco for a declaratory judgment that Axis was not  
16 obligated to pay under the policy.

17           That was followed by different responses by various  
18 groups of defendants. First, one group of defendants  
19 represented by Weil, Gotshal moved to dismiss Axis' adversary  
20 complaint. Second, another group of officers and directors made  
21 a counterclaim for the advancement of defense costs, and third,  
22 the present group, Grant, Trosten and Bennett joined in or  
23 purported to join in both of those requests for relief. I  
24 granted the motion to dismiss Axis' request for a declaratory  
25 judgment as to its obligation generally under the policy to

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1 provide coverage on the basis of the so-called substantial  
2 overlap doctrine as set forth in numerous cases, including --  
3 by Judge Cote in In re: Worldcom, Inc. Securities Litigation,  
4 2002 W.L. 31729501 (S.D.N.Y., December 5, 2002) as well as in  
5 Adelphia and Enron.

6           The basis set forth in my bench ruling was that  
7 ultimately the facts that Axis would need to establish to  
8 prevail on its claim and to the contrary the facts that the  
9 defendants would need to refute to defeat Axis' claim  
10 substantially overlap with facts that would also in all  
11 likelihood arise in the pending securities litigation before  
12 District Judge Lynch as well as potentially in the District  
13 Court criminal litigation against Grant, Trosten and Bennett.

14           Turning then to the counterclaim and related request  
15 for a preliminary injunction, I determined that there was a  
16 likelihood of success on the merits and irreparable harm and  
17 absent such sufficient questions going to the merits and the  
18 balance of harms in favor of the counter-claimants to support  
19 an injunction requiring the advancement of their defense costs  
20 billed through the date of my order.

21           However, I also concluded that procedurally the  
22 request for the same relief by Messrs. Grant, Trosten and  
23 Bennett was not properly before me as they themselves had not  
24 made a counterclaim and there was no adversary proceeding  
25 asserting their claims against Axis and consequently no basis

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1 for granting them a preliminary injunction. They subsequently  
2 remedied that procedural defect by commencing an adversary  
3 proceeding and seeking and obtaining expedited hearing on their  
4 motion for a preliminary injunction for the advancement of  
5 defense costs.

6 I should note as an aside that the parties should,  
7 unless I'm missing something, promptly consolidate this  
8 adversary proceeding with the counterclaim which is now its own  
9 adversary proceeding brought by the defendant's representative  
10 in part by Baker & Hostetler.

11 I won't go over at length the findings that I made  
12 and the rulings that I made at the prior hearing. They're set  
13 forth in the transcript which I've reviewed as far as typos and  
14 misheard words are concerned corrected and I hope that's what  
15 the parties have. I think it is.

16 I'll note that there was a procedural matter that --  
17 consistent with some of my remarks on the record Axis has  
18 subsequently moved in the District Court for withdrawal of the  
19 reference of the adversary proceeding and that well may be  
20 heard before the hearing that I've scheduled for mid-October on  
21 the ultimate relief requested by the counterclaim plaintiffs  
22 and by Grant, Trosten and Bennett against Axis.

23 However, pending a determination of that motion for  
24 withdrawal of the reference I continue to have jurisdiction and  
25 as noted at the prior hearing and I think is reiterated today

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1 in the colloquy with counsel for the Refco plan administrator,  
2 I believe I have jurisdiction over this matter and this  
3 adversary proceeding because it is one in which I am asked to  
4 interpret the provisions of the Axis policy which is property  
5 of the debtor's estate and secondly because the payments under  
6 the policy affect distributions to creditors in this estate,  
7 either creditors with indemnification claims such as the  
8 directors and officers or perhaps ultimately securities law  
9 creditors and others who have made claims not only against  
10 Refco but also against officers and directors and under the  
11 plan who agreed to a mechanism for pursuing those claims  
12 jointly with the Refco estate.

13           This motion before me also seeks relief from -- what  
14 it says is the automatic stay to permit payment of the  
15 insurance proceeds in respect of the advancement of defense  
16 cost which is also a core matter. However, as I noted at the  
17 last hearing, Paragraph 34 of the confirmation order provides  
18 that the automatic stay itself is no longer in place. However,  
19 it also notes that it does not otherwise amend the plan and the  
20 other provisions of the confirmation order which does contain  
21 its own plan injunction which may be implicated by the payment  
22 of the defense costs.

23           In any event, because of that request which I am  
24 taking as a request for relief from the plan injunction as  
25 opposed to from the automatic stay, I also as a third basis

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1 have jurisdiction here because ultimately I'm being asked to  
2 interpret the plan and enforce the plan by considering relief  
3 from the injunction in the plan.

4 In short, the basis for the request for a preliminary  
5 injunction is the movants' contention that under the applicable  
6 insurance policies, which include the primary policies as  
7 incorporated in the Axis policy, Axis is obligated to advance,  
8 that is pay defense costs subject to reimbursement if it's  
9 ultimately concluded that such defense costs were not covered  
10 under the policy.

11 The movants contend that that contractual language  
12 when coupled with the various presumptions regarding  
13 interpretation of insurance policies under New York law  
14 particularly provisions of insurance policies dealing with  
15 exclusions and dealing with defense costs is clear and that  
16 there's a substantial likelihood that they would prevail on the  
17 merits.

18 They also contend that given the amount of defense  
19 costs that have been incurred to date and the fact that they  
20 are criminal defendants subject to freeze orders the failure to  
21 advance the defense costs irreparably harms them in that it  
22 impairs their ability to mount an effective defense in this  
23 case of a criminal indictment.

24 They also contend that even if they were not a  
25 substantial likelihood of success the balance of harms tips in

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1 their favor given the foregoing contentions and the opposite  
2 consideration that Axis is a very substantial corporation and  
3 that it agreed to make these payments and take the risk of non  
4 payment in the policy.

5 Finally, they state as a matter of public policy they  
6 should not be saddled with the payment of the defense costs  
7 since that would vitiate the purpose of a DNO policy and  
8 ultimately discourage parties from serving as officers and  
9 directors of a corporation.

10 They have not presented any other evidence than the  
11 amount of the defense costs and the fact that they are facing a  
12 criminal trial in March of 2008 and the request for me to take  
13 judicial notice of freeze orders. That is, they've not offered  
14 evidence as to their financial condition or the law firm's  
15 willingness to work with the overhanging uncertainty as to  
16 whether they would ultimately be paid for conducting the  
17 movants' defense.

18 Axis has responded by first disputing that there was  
19 a substantial likelihood that the movants would ultimately  
20 prevail on the merits. It is also contended that as a factual  
21 matter irreparable harm has not been shown and that neither has  
22 a balance of the equities tipping in favor or balance of the  
23 harms tipping in favor of the movants. They also contend that  
24 the public policy cited by some of the courts that have  
25 previously considered this issue is less significant where an

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1 officer and director is the subject of a criminal indictment  
2 and is being defended in a criminal proceeding. It has sought  
3 a bond under Rule 65(c) as well.

4 Finally, it has contended that the relief that is  
5 sought here is fundamentally inequitable because the movants  
6 had previously joined in the motion which was successful to  
7 dismiss Axis' declaratory judgment complaint.

8 As far as the amount of the defense cost is  
9 concerned, I believe the record is now clear that through the  
10 date of my prior injunction order, August 31st, the costs  
11 billed was approximately \$1.6 million for these three movants  
12 and that is approximately \$2.9 million as of today. The policy  
13 itself has a \$10 million limit.

14 Clearly, as far as these defendants are concerned,  
15 they have been in serious litigation mode with very large  
16 defense costs being incurred since July of this year and it is  
17 likely that that will continue over the next several months as  
18 they prepare for trial in what appears to be a complex, at  
19 least as a factual matter, case. And I'll note in that regard  
20 that I take judicial notice of the cost incurred by the Refco  
21 estate of examining the facts and circumstances surrounding the  
22 claims that at least overlap with the claims against Mr.  
23 Bennett and the other two criminal defendants, costs which I  
24 had to approve before they were paid.

25 Let me turn to the last point raised by Axis first.



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1 I concluded last week that it is not inequitable to proceed  
2 with this claim and to grant preliminary injunctive relief  
3 notwithstanding the movants' prior request to dismiss Axis'  
4 complaint although they along with Weil, Gotshal were  
5 successful in that request or the Weil, Gotshal defendants were  
6 successful in that request. I do not believe there is a basis  
7 for judicial estoppel here because I believe that the issues  
8 pertaining to the motion to dismiss are fundamentally different  
9 than the issues presented by the claim asserted in the present  
10 adversary proceeding as well as the counterclaim asserted by  
11 the other defendants.

12           As I noted previously, the basis for this request is  
13 one in which I need not consider the factual issues that  
14 overlap with the District Court securities litigation and the  
15 criminal litigation but rather need only consider the language  
16 of the contract, that is the insurance policies and the related  
17 warranty and applicable case law. If, in fact, I were to  
18 conclude ultimately that Axis was not obligated to advance  
19 defense costs but could withhold those costs pending a  
20 determination as to whether they were -- whether Axis would be  
21 successful in concluding that this denial of coverage was  
22 appropriate and correct then there would be an overlap and at  
23 that point this adversary proceeding and the adversary  
24 proceeding brought by the counterclaim parties would be either  
25 stayed or dismissed without prejudice pending the development

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1 of those facts in the multi district securities litigation  
2 and/or the criminal case. But I believe I can and unless the  
3 reference is withdrawn I must consider whether as a matter of  
4 reading the insurance policies and the case law and the related  
5 warranty whether there is a separate obligation to advance  
6 defense costs prior to determination of the underlying coverage  
7 dispute based on whether there was a represent -- a breach of  
8 the representation -- a breach of the so-called warranty and/or  
9 the exclusions in the policy relied upon by Axis for disclaimer  
10 of coverage.

11           Turning then to the other defenses raised by Axis,  
12 let me address first the appropriate standard by which I should  
13 consider the motion here for a preliminary injunction. Axis  
14 contends that because the relief sought here is one in which  
15 Axis would be compelled to advance defense costs, this is a  
16 request for mandatory injunctive relief rather than for a  
17 prohibitory injunction. Consequently, Axis argues I need to  
18 consider the request pursuant to a heightened standard that  
19 applies to mandatory injunctions where I would have to find on  
20 the merits a substantial likelihood that the plaintiffs would  
21 ultimately prevail. See, for example, Tom Doherty Associates,  
22 Inc. v. Sabian Entertainment, Inc., 60 F.3d 2735 (2d Cir.  
23 1995). In that case, the Second Circuit noted that the  
24 distinction between a mandatory and a prohibitory injunction  
25 has been the subject of criticism and particularly noted the

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1 criticism of that standard in respect of breach of contract  
2 cases where one party's assertion that the status quo is merely  
3 being maintained is another party's assertion that that party  
4 is actually breaching the status quo by breaching the  
5 underlying agreement.

6           This very issue was addressed by what I believe to be  
7 the leading case or the most relevant case to the issues before  
8 me, that is Judge Cote's opinion in In re: Worldcom, Inc.  
9 Securities Litigation, 354 F. Supp. 2d. 455 (S.D.N.Y. 2005) in  
10 which she concluded ultimately that the heightened standard for  
11 a preliminary mandatory injunction does not apply to a motion  
12 for a preliminary injunction for the advancement of defense  
13 costs for the reason that -- for the reasons that she lays out  
14 at Page 463 of that opinion. She notes first that in that  
15 matter as well as here given that the amount at issue is well  
16 under the policy limit that a preliminary injunction would not  
17 make it difficult or impossible to render a meaningful remedy  
18 to a defendant who prevails on the merits at trial in that only  
19 part of the benefits to which the director, in this case the  
20 directors and officers are seeking ultimately would be covered  
21 here in the injunction. And, secondly, that the policy itself  
22 contemplated reimbursement.

23           That view was also recently followed in Great  
24 American Insurance Company v. Gross, 2005 U.S. District Lexus  
25 8003 (E.D. Virginia, May 3, 2005) which was vacated on other

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1 grounds, 468 F. 3d 199 (4th Cir. 2006).

2           So I don't believe that I must follow the heightened  
3 standard requiring the finding of clear likelihood or a  
4 likelihood of success on the merits. Nevertheless, I have  
5 considered obviously whether there would be a likelihood of  
6 success on the merits as did Judge Cote in the Worldcom case  
7 but did not limit my inquiry to that analysis but considered  
8 also the regular standard.

9           I conclude that, as did Judge Cote in her words,  
10 nevertheless even if the heightened standard applies I believe  
11 that the movants here have established a clear likelihood of  
12 success on the merits.

13           Let me turn to the merits now. As Judge Cote  
14 recognized, under New York law, and as an aside I previously  
15 concluded that New York law should apply to disputes in respect  
16 of this insurance coverage for the reasons set forth in my  
17 earlier bench ruling, while the plain language of an insurance  
18 agreement as with any contract covered by New York law is the  
19 best evidence and if unambiguous the only evidence of the  
20 parties' intentions and as a matter of law for the Court to  
21 decide in respect of insurance contracts to the extent of an  
22 ambiguity exists and is unresolved by extrinsic evidence such  
23 ambiguity is read against the insurer. The rule that insurance  
24 policies are to be construed in favor of the insured is most  
25 rigorously applied in construing the meaning of exclusions

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1 incorporated into a policy of insurance or provision seeking to  
2 narrow the insurer's liability. And, finally, that where a  
3 contract of insurance includes the duty to defend or to pay for  
4 the defense of its insured that duty is a heavy one.

5 As set forth by Judge Cote, in addition, under New  
6 York law, including as interpreted by the Appellate Division in  
7 the Koslowski Tyco case, as well as by numerous Southern  
8 District courts, the duty of an insurer to pay an insured's  
9 defense costs is distinct from and broader than its duty  
10 ultimately to indemnify even where the policy does not provide  
11 specifically for when defense costs are to be advanced. It has  
12 been held that they need to be advanced as incurred under a  
13 liability policy as set forth in Judge Baer's Newway decision.

14 Moreover, it appears clear to me under New York law  
15 that the duty to pay defense costs exists whenever a complaint  
16 against the insured alleges claims that may be covered under  
17 the insurer's policy. That is, if it appears from the face of  
18 the underlying complaint against the insured that there is an  
19 issue as to whether that complaint sets forth a claim that may  
20 be covered the costs would need to be advanced. See, for  
21 example, the Koslowski Tyco case as well as the Newway decision  
22 which appears at 1997 U.S. District Lexus 11884 (S.D.N.Y.  
23 August 12, 1997).

24 The opposition to the motion by Axis attempts to make  
25 a distinction between situations where the courts have

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1 considered refusal to pay defense costs because the insurer has  
2 sought or has taken the position that the policy was rescinded.  
3 It has also taken the position that there should be a  
4 distinction between the present matter and decisions which have  
5 dealt with the duty to defend as opposed to a duty to advance  
6 defense costs. But I conclude based on my review of the case  
7 law that where an insurer takes the position that a claim is  
8 not covered and therefore it is not obligated to advance  
9 defense costs those distinctions are not meaningful in that  
10 they apply in cases of rescission, cases where there's an  
11 alleged obligation to advance and cases where there's an  
12 alleged obligation to defend.

13 For example, in the Tyco Koslowski matter the insurer  
14 alleged that the underlying claims were not covered and  
15 therefore the defense costs would not be covered either. The  
16 Court held, however, that unless the insurer has no duty as a  
17 matter of law it would have an obligation to advance the  
18 defense costs stating that the duty to defend or pay defense  
19 costs is construed liberally and any doubts about coverage are  
20 resolved in the insured's favor. Furthermore, an insurer can  
21 only invoke a policy exclusion to avoid coverage if it can show  
22 that the allegations in the complaint cast that pleading solely  
23 and entirely within the policy exclusions. The duty to defend  
24 arises when the action is brought and is unaffected by the  
25 outcome of the action. See, also, Pepsico, Inc. v. Continental

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1 Casualty Company, S.D.N.Y. 1986, McGinnis v. Employer's  
2 Reinsurance Corporation, 648 F. Supp. 1263 (S.D.N.Y. 1986), The  
3 Great American Insurance Company v. Gross case that I referred  
4 to earlier and G1 Holdings, Inc. v. Hayman -- I'm sorry, G1  
5 Holdings, Inc. v. Reliance Insurance Company, 2006 U.S.  
6 District Lexus 17597 (D. New Jersey, March 22, 2006).

7           Axis' response, in addition to saying that it need  
8 not advance the costs pending resolution of the dispute, is  
9 that it is clear from the language of the insurance policy  
10 itself that there is no way that it would be obligated to  
11 provide coverage here.

12           As I noted in my prior ruling on the earlier request  
13 for an injunction, this is ultimately premised upon Axis'  
14 reading of Paragraph D2 of the underlying policy which states  
15 that the insurer will pay covered defense costs on an as  
16 incurred basis. If it is finally determined that any defense  
17 costs paid by the insurer are not covered under this policy the  
18 insured's agree to repay such non covered defense costs to the  
19 insurer. Axis contends that because of the word covered in the  
20 first sentence it need not pay costs that are not covered under  
21 the policy.

22           I conclude that it is likely that that interpretation  
23 will not prevail given the foregoing case law as well as the  
24 provision when read as a whole which first requires the insurer  
25 to pay covered defense costs on an as incurred basis, i.e. not

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1 waiting until an ultimate determination but as incurred with  
2 out of pocket payment. Secondly, the second sentence which  
3 provides for reimbursement if it is finally determined that any  
4 defense costs paid by the insurer were not covered. Axis  
5 contends that the word covered in the first sentence has to  
6 mean covered by the policy but I have two responses to that.

7           The first is that I see little difference between  
8 that argument and an argument that says that as in the cases  
9 that I previously cited a defense cost falls into an exclusion  
10 because it's not for costs determined to have arisen from  
11 defense of a claim covered by a policy, i.e. the policy it was  
12 argued in those other cases doesn't cover certain types of  
13 claims and therefore the defense costs also would not fall into  
14 the coverage of the policy. Notwithstanding those arguments,  
15 courts like the Koslowski court determined that the costs  
16 should be advanced pending ultimate determination of that  
17 issue.

18           Secondly, covered when one looks at the definition of  
19 defense costs and loss in the first sentence, covered as used  
20 in the first sentence after looking at those definitions could  
21 mean whether it pertained to insured persons or not or whether  
22 those persons had become legally obligated or not to make the  
23 payments of their defense costs.

24           So, in any event, I believe that ultimately it is  
25 likely that the movants here would prevail on the merits. I



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1 conclude that the following paragraph of the policy which deals  
2 with the allocation of losses covered and losses not covered by  
3 the policy does little to advance Axis' interpretation and may  
4 slightly advance the movants' in that it would seem to be  
5 superfluous if Axis' interpretation were the correct one. That  
6 is, you would not need to provide for a distinction between  
7 losses covered and losses not covered if the insurer could  
8 withhold under Paragraph 2, defense costs that it believed were  
9 not covered.

10 I do not believe the language which again requires  
11 payment on an as incurred basis is materially different from  
12 the language quoted by Judge Cote in the Worldcom case and  
13 would need to be far clearer to create an exclusion here.

14 Turning to the issue of irreparable harm, Judge Cote  
15 found in Worldcom that wherever individual officers and  
16 directors were faced with substantial defense costs that were  
17 not being paid they would -- they were subject to irreparable  
18 harm. As she says, it is impossible to quantify the impact on  
19 a litigant of a failure to have adequate representation at this  
20 critical stage of litigation. The ability to mount a  
21 successful defense requires competent and diligent  
22 representation. The impact of an adverse judgment will have  
23 ramifications beyond the money that will necessarily be  
24 involved. That's especially true as noted by Judge Gerber in  
25 the Adelphia Regis case where the insured or the beneficiary of

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1 the policy is the subject of a criminal proceeding.

2 Judge Cote's not alone in finding irreparable harm in  
3 these circumstances. It was also found in the G1 and Gross  
4 cases that I cited earlier as well as in McPeek v. Travelers  
5 Casualty & Surety Company of America, 2006 U.S. District  
6 Lexus -- I'm sorry, excuse me. Let me back up.

7 It was recognized in the Bondex International, Inc.  
8 v. Hartford Accident & Indemnity Company case, 2006 U.S.  
9 District Lexus 50083 (N.D. Ohio, July 21, 2006) to apply in a  
10 case of an individual beneficiary or insured under a director's  
11 and officer's policy but would not apply to a corporation at  
12 least absent evidence of insolvency which again I believe  
13 heightens or puts a fine point upon the burden faced by an  
14 individual here.

15 There is one case that takes a contrary view and that  
16 is the McPeek case that I started to cite earlier. McPeek v.  
17 Travelers Casualty & Surety Company of America, 2006 U.S.  
18 District Lexus 28619 (W.D. Pennsylvania, May 10, 2006) in which  
19 the Court found there was not irreparable harm because there  
20 had not been a showing, a factual showing that the  
21 beneficiaries there would be unable to mount a defense.

22 There may conceivably be circumstances where an  
23 additional factual showing would need to be made to establish  
24 irreparable harm in this context but I believe that there's a  
25 sufficient record before me to show irreparable harm given the

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1 substantial amount of the defense costs, the freezing of the  
2 defendant's assets and the fact that they're subject to  
3 criminal exposure. So to the extent that I find McPeck at all  
4 persuasive I believe it's distinguished under the present  
5 circumstances as did Judge Cote. Therefore, I've concluded,  
6 although I do not believe the heightened standard needs to  
7 apply, that the movants meet it here.

8           Turning, however, to the ordinary standard for a  
9 preliminary injunction, I've already discussed the merits and  
10 even if one were not to take the view that there was a clear or  
11 substantial likelihood of success, for the reasons I've stated  
12 I believe there is definitely sufficient issues going to the  
13 merits that I would turn then to the balance of harms as the  
14 merits are fair ground for litigation.

15           I conclude that the balance of harms tips decidedly  
16 in favor of the movants here. I believe that although she did  
17 not have a heading in her opinion in which she balanced the  
18 harms, Judge Cote did consider the harm not only to the movant  
19 in not granting injunctive relief but also to the potential  
20 harm to the insurer were she to grant the relief and concluded  
21 as I conclude here that the balance of harms tip decidedly in  
22 favor of the movant and that is she discussed the fact that the  
23 -- in her belief there was no undue hardship on the insurer as  
24 its liability is ultimately capped and secondly, that the  
25 policy set out a mechanism that the insurer bargained for for

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1 reimbursement ultimately and that particularly in light of the  
2 potential harm to the movant and the public interest in favor  
3 of advancing the defense costs, the insurer should not be  
4 entitled to more.

5 In a more explicit analysis on both the McPeek and  
6 Great American v. Gross case, similarly found a balance of  
7 harms tipping in favor of the movant as well as the public  
8 interest being in favor of the movant.

9 As noted at oral argument, Axis had cited to me an  
10 unpublished, including not appearing on either Lexus or  
11 Westlaw, ruling by Judge Wood in a civil matter, Gayon v. Twin  
12 City Fire Insurance Company. I've reviewed that  
13 notwithstanding the Second Circuit's rule on citation to  
14 unpublished opinions and the fact that a copy of the ruling was  
15 not obtainable by the Court or provided to the Court prior to  
16 oral argument and I conclude first that the decision by Judge  
17 Wood is distinguishable in that she had to my mind a far  
18 different view of the underlying merits of the case which is a  
19 very different case than the case before me. Note further that  
20 while she mused that cases such as Worldcom may not have  
21 considered sufficiently the balance of harms or the balance of  
22 the equities, I do not view her as ultimately ruling on that  
23 basis.

24 In any event, again, as I distinguished the McPeek  
25 case, I believe that the amount at issue here and the fact that

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1 this is a criminal matter distinguish the present matter from  
2 Gayon.

3 As far as Axis' request that the movants post a bond  
4 under Rule 65(c) incorporated by Rule 7065, I again follow the  
5 logic set forth by Judge Cote in Worldcom which was also  
6 adopted by the Great American v. Gross and G1 cases that I  
7 cited earlier effectively to require a bond here in my view  
8 would vitiate the entire ruling particularly since these are  
9 individual defendants. In essence, it would under the guise of  
10 obtaining a bond require the movants to pay for insurance all  
11 over again notwithstanding the language of the policy.

12 So I exercise my discretion not to require a bond in  
13 these circumstances. I do so also mindful that the amount that  
14 I'm going to require to be advanced is well within the capped  
15 amount of the policy and that as I noted earlier the ultimate  
16 issues here are teed up for a final determination in 31 days  
17 and that leads into the last part of my ruling.

18 It was requested by Axis that I rule as to the proper  
19 allocation or priority of payment of funds directed to be paid,  
20 if any, by me. I do not believe that request is appropriately  
21 before me given the seriousness of it the parties who would be  
22 affected by it and the limited amount of notice. As  
23 importantly, I don't believe it's a ripe question because I  
24 don't believe any other priority or any priority issues are  
25 necessarily determined by my ruling today and further, although

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1 this is not critical to my ruling, I don't believe that my  
2 ruling today would put Axis in a position of acting at its  
3 peril and paying out one way or another under the policy which  
4 is generally disclaimed and refused to pay out under absent a  
5 judicial ruling requiring it to do so.

6           It appears to me that therefore an order requiring  
7 payment with a full reservation of rights as to the allocation  
8 or priority of payment generally under the policy is  
9 appropriate. I've determined given the record as to the  
10 billing of costs and the incurrence of costs that it would be  
11 appropriate to require Axis to advance the defense costs to  
12 these three movants billed through the date of my prior order  
13 so that there's no, if you will, acceleration of billing, and  
14 that in my view the costs through the date of the prior order  
15 were in large measure billed in the ordinary course and I think  
16 appropriately paid.

17           I also believe that requiring the payment through  
18 that date puts these three movants on an even footing with the  
19 other movants who previously obtained the preliminary  
20 injunction. Given that I will be ruling unless the reference  
21 is withdrawn at or around October 12th, I believe that my  
22 present ruling would provide sufficient comfort to the law  
23 firms defending these three individuals that they will continue  
24 to provide the same level of service going forward without the  
25 necessity of paying them the additional amounts that have been

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1 billed starting in September and through today and that such  
2 payments would not be necessary to avoid irreparable harm in  
3 light of this ruling.

4           So it's been represented by counsel for the movants  
5 that they would propose an order that's substantially similar  
6 if not essentially similar to the prior injunction that I had  
7 entered I believe it would contain the language about though  
8 the reservation and preservation of all issues as to priority  
9 of payment. Have you -- do you have such an order?

10           MR. EISEN: Your Honor, I have the following order. I  
11 also have a disk. This order is identical other than changing  
12 the identities of the parties. I provided a copy to Ms.  
13 Gilbride and I provided a copy to Ms. Kim before the hearing  
14 today. If the Court likes as last time I can hand this draft  
15 up and the Court can --

16           THE COURT: Does it have the language about the  
17 reservation of rights as to priority?

18           MR. EISEN: It does not have the language about  
19 reservations of rights.

20           THE COURT: All right. Well, you should consider the  
21 injunction effective as of today but I think you should  
22 circulate that language because I think it's meaningful to the  
23 parties and you can submit an order tomorrow. It's 1:20 now.  
24 You may get it in today but submit it with that language. You  
25 don't have to settle it on the parties but they'll have some

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1 time. You should email it to them at the same time you submit  
2 it to Chambers. They can tell me if it doesn't agree with my  
3 ruling.

4 MR. EISEN: I will, Your Honor.

5 MS. GILBRIDE: Your Honor, given the amount of money  
6 involved and the fact that we've only recently received most of  
7 these bills, Axis would respectfully request a reasonable  
8 amount of time to review the bills and --

9 THE COURT: It's the same as the last ruling. I think  
10 it's -- it doesn't change anything as far as the policy, as far  
11 as your other rights under the policy including reviewing the  
12 bills, et cetera.

13 MS. GILBRIDE: It's just the turnaround time. Since  
14 we've just gotten the bills it does take a little bit of time  
15 to review the bills.

16 THE COURT: Again, this doesn't change that. I'm not  
17 saying you pay them tomorrow.

18 MS. GILBRIDE: I think the order says that we pay them  
19 within ten days of the order.

20 MR. EISEN: Your Honor, if I understand the Court  
21 correctly, it's only the bills that were presented to Axis as  
22 of the Court's previous --

23 THE COURT: The date was August 31st.

24 MR. EISEN: August 31st.

25 MS. GILBRIDE: Presented to us or through that day?



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1 THE COURT: Yes, billed. Billed.

2 MR. EISEN: It's that the -- what I understood the  
3 Court to be saying was the insurers had -- if the insurer had  
4 the bills in hand as of August 31.

5 THE COURT: Okay.

6 MS. GILBRIDE: Thank you.

7 THE COURT: Now, as far as -- I know we're having -- I  
8 had previously scheduled a telephonic conference on the 14th.  
9 I saw the result in front of Judge Koetl. I don't know whether  
10 there will be a motion for a stay or not. I don't know where  
11 you're going with withdrawal of the reference but I would like  
12 to keep this on track for the 12th. So --

13 MS. KIM: Yes, Your Honor, that is our intention to  
14 keep the motion for summary --

15 THE COURT: So I think we should still have that  
16 conference on the 14th.

17 MS. KIM: That's fine, Your Honor. With respect to  
18 Judge Koeltl, Judge -- we had an oral argument last Wednesday.

19 THE COURT: I read the -- someone attached the  
20 transcript and the ruling. So I'm up to date on that I think  
21 unless there -- I read what was attached to the exhibit as an  
22 exhibit.

23 MS. KIM: Well, actually that transcript, Axis  
24 submitted a letter --

25 THE COURT: I saw that. I saw that. Very well.

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1 Raise the issue of mediation. This is perhaps an appropriate  
2 thing for the parties to do. I did not hear Axis say whether  
3 it would be amenable to mediation or not. I think it would need  
4 to include the other insurers. It seems to me that the parties  
5 should consider mediation but I don't believe that these issues  
6 should be put on hold unless there is substantial progress in  
7 such a mediation. It seems to me that, as I noted at the last  
8 hearing --

9 MS. GILBRIDE: Just so Your Honor is clear, it was  
10 actually Axis' suggestion initially.

11 THE COURT: That's fine. I'm happy if Axis wants to  
12 mediate but I think there are other insurers involved and that  
13 would be fine to have happen but there's a -- I believe there's  
14 a legal regime that governs in this area where insurers refuse  
15 to pay under policies and the parties are free to mediate but  
16 that legal regime governs and I think it needs to be followed  
17 because there are consequences beyond just a ruling by the  
18 Court as to whether the insured failed to pay or not. So I'm  
19 not going to hold off in the litigation unless there's  
20 substantial progress on a mediation and I encourage the parties  
21 to try to make substantial progress on it. But I'm afraid the  
22 parties means not just Axis but other parties. This is not a  
23 litigation matter. This is a mediation matter and I think is a  
24 practical matter to mediate it you're going to need other  
25 parties, the other insurers.

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1 Ms. Kim.

2 MS. KIM: Your Honor, just one last housekeeping  
3 matter. Our intervention motion, I don't think anyone -- no  
4 one opposed it. So if you could just --

5 THE COURT: That's fine. I obviously heard you all.  
6 Again, the two proceedings should be consolidated I believe.  
7 They raise the same issues in terms of interpreting the  
8 contract at least.

9 MR. EISEN: Your Honor, we would move for  
10 consolidation. If the Court wants to order that now then we'll  
11 take the appropriate steps with the clerk.

12 THE COURT: Do you want to think about that?

13 MS. GILBRIDE: Your Honor, we would appreciate an  
14 opportunity to consider that.

15 THE COURT: That's fine. That's fine. It seems to me  
16 it's sort of --

17 MR. EISEN: Thank you, Your Honor.

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I certify that the foregoing is a court transcript from an electronic sound recording of the proceedings in the above-entitled matter.

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Shari Riemer

Dated: September 12, 2007